ECORD
AND
BRIEFS

No. 15-1189

IN THE

Supreme Court of the United States

IMPRESSION PRODUCTS, INC.,
Petitioner,

v.

LEXMARK INTERNATIONAL, INC.,
Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FEDERAL CIRCUIT

BRIEF OF INTEL CORP., DELL INC., AND VIZIO INC. AS *AMICI CURIAE* IN SUPPORT OF PETITIONER

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QUESTIONS PRESENTED

1. Whether a sale that transfers title to the patented item while specifying post-sale restrictions on the article's use or resale avoids application of the patent exhaustion doctrine and therefore permits the enforcement of such post-sale restrictions through the patent law's infringement remedy.

2. Whether, in light of this Court's holding in *Kirtsaeng v. John Wiley & Sons, Inc.*, 133 S. Ct. 1351, 1363 (2013), that the common law doctrine barring restraints on alienation that is the basis of exhaustion doctrine "makes no geographical distinctions," a sale of a patented article—authorized by the U.S. patentee—that takes place outside of the United States exhausts the U.S. patent rights in that article.

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INTEREST OF *AMICI*[1]

Amici are leading members of the U.S. high-technology industry. Intel Corp. is a designer, manufacturer, and seller of microprocessors, communication chips, flash memory products, solid-state drives, and other high-technology products and services. Dell Inc. is a manufacturer of personal computers, data storage solutions, and other technology products. VIZIO, Inc. is a consumer electronics company whose products include televisions, displays, and audio equipment. Together, *amici* own more than 35,000 patents.

Amici manage and participate in complex global supply and distribution chains for high-tech products—both at the beginning and end of the global supply chains. For example, Intel makes highly complex microprocessor chips that are at the center of a wide range of computing products. "[E]ach Intel microprocessor and chipset practices thousands of individual patents," *Quanta Computer, Inc. v. LG Elecs., Inc.*, 553 U.S. 617, 635 (2008), some of which Intel owns and some of which Intel licenses from other companies. Intel then sells its microprocessor chips to other companies, like Dell, that combine them with other patented components—including many supplied by other third parties from outside the United States—into their complex technological products. VIZIO also

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[1] The parties have consented to the filing of this *amicus* brief. No counsel for a party authored the brief in whole or in part. No party, counsel for a party, or any person other than *amici* and their counsel made a monetary contribution intended to fund the preparation or submission of this brief.

relies on foreign manufacturers to procure components and assemble VIZIO's products.

Amici submit this brief out of deep concern for the practical consequences of the decision below. As owners of patents and as manufacturers who use patented components in their products, *amici* rely on the principle that one authorized sale of a patented item exhausts the patent holders patent rights in that item. This principle translates into fair marketplaces for innovation and technology, ultimately promoting progress and yielding benefits to consumers. Without patent exhaustion, a patent holder could choose to sell its patented component for use in a high-tech product, receive its reward in the form of the freely negotiated contract price, and then attempt to extract second, third and fourth royalties all the way down the supply chain. That could impact the marketplace for all sorts of products, increasing consumer costs and undermining the progress the patent system was designed to incent.

INTRODUCTION AND SUMMARY OF ARGUMENT

"The declared purpose of the patent law is to promote the progress of science and the useful arts by granting to the inventor a limited monopoly, the exercise of which will enable him to secure the financial rewards for his invention." *United States v. Univis Lens Co.*, 316 U.S. 241, 250 (1942). "[W]hen the patentee has received his reward for the use of his invention by the sale of the article," that purpose "is realized [and] the patent law affords no basis for restraining the use and enjoyment of the thing sold." *Id.*

at 251; *see also Kirtsaeng v. John Wiley & Sons, Inc.*, 133 S. Ct. 1351, 1363 (2013) ("[T]o control the resale or other disposition of a chattel once sold is ... 'against Trade and Traffi[c], and bargaining and contracting'" (quoting 1 E. Coke, Institutes of the Laws of England § 360, p. 223 (1628))).

The Federal Circuit's two rulings under review here—originally announced in *Jazz Photo Corp. v. International Trade Commission*, 264 F.3d 1094 (Fed. Cir. 2001), and *Mallinckrodt, Inc. v. Medipart, Inc.*, 976 F.2d 700 (Fed. Cir. 1992)—create two unwarranted exceptions to that rule. Although the Federal Circuit denied its decision would cause "substantial" or "wide-spread" problems to the global marketplace, Pet. App. 60a, 98a, 100a, *amici* submit this brief to help illustrate the real-world problems with the Federal Circuit's approach.

I.A. One hundred and sixty five years of this Court's precedent supports the rule that "the initial authorized sale of a patented item terminates all patent rights to that item." *Bowman v. Monsanto Co.*, 133 S. Ct. 1761, 1766 (2013) (quoting *Quanta Comput., Inc. v. LG Elecs., Inc.*, 553 U.S. 617, 625 (2008)); *see also Bloomer v. McQuewan*, 55 U.S. 539, 549 (1852). *Jazz Photo* created an exception for authorized sales that take place outside the United States. The en banc majority reaffirmed that exception, purporting to rely on *Boesch v. Graff*, 133 U.S. 697 (1890). But the Federal Circuit's understanding of *Boesch* was flawed. In *Boesch*, there was no exhaustion because there was no sale authorized by the U.S. patent holder.

B. *Jazz Photo* has imposed unwarranted transaction costs on high technology. Companies like *amici* who make devices that each implicate thousands of patents must secure licenses to protect themselves and their customers from claims of patent infringement, even for products that were purchased abroad in sales authorized by the U.S. patent holder.

Lexmark argues that requiring downstream manufacturers to negotiate second, third and fourth licenses, even after the patent holder has received her patent reward, is how the system *should* work. *See* Opp. 32. But a rule that requires duplicative licensing imposes massive transaction costs with no corresponding benefit, aside from wealth to the patentee. The total cost for licensing patents in a single high-tech product could be in the tens, if not hundreds, of millions of dollars. And even express licenses have not stopped patent assertion entities ("PAEs") from filing suit against downstream purchasers. Moreover, under *Jazz Photo*, licensing, and its attendant transaction costs, must be duplicated at each level of the supply chain. A downstream purchaser cannot be assured that its supplier has secured exhaustion without reviewing the license between the supplier and the patent holder—but patent licenses are generally confidential and unavailable to the downstream purchaser. When a downstream purchaser therefore must negotiate directly with a patent holder, the downstream purchaser is at a serious disadvantage, both because it may already be locked into using the patented technology, and because it lacks the technical information and expertise to evaluate whether the component may practice the patent or to calculate the value of the technology to its product.

C. The Solicitor General correctly rejects *Jazz Photo's* rule that international sales authorized by the U.S. patentee can never exhaust U.S. patent rights. But to support its rule of presumptive international exhaustion, the government relies on two bilateral free trade agreements with Australia and Morocco. Those two agreements do not establish U.S. law or policy, and nothing in either requires signatories to provide patent holders with a remedy that sounds in patent law instead of contract law. And a rule of international exhaustion would still allow patent holders to prevent the importation of products through contract law. Relying on contract law would limit legal liability to the parties to the contract, and those in privity with them, without imposing a servitude on the product itself. Moreover, the government's approach does not solve the practical problems *amici* face under *Jazz Photo*.

II.A. As the government correctly argues, this Court should also reject the Federal Circuit's embrace of *Mallickrodt's* holding that post-sale restrictions may be enforced through patent law. U.S. Cert. Br. 6-14. This Court has consistently held that the "sale of [an article] exhausts the monopoly in that article and the patentee may not thereafter, by virtue of his patent, control the use or disposition of the article." *Univis Lens Co.*, 316 U.S. at 250 (1942). The en banc majority wanted to avoid creating a "distinction that gives less control to a practicing-entity patentee that makes and sells its own product than to a non-practicing-entity patentee that licenses others to make and sell the product." Pet. App. 26a. But there is no such distinction. The rule is the same for non-practicing entities and practicing entities alike: Once there

has been a first sale authorized by the U.S. patent holder, the patent holder may not exercise any further control over the use or resale of the patented article through the patent law.

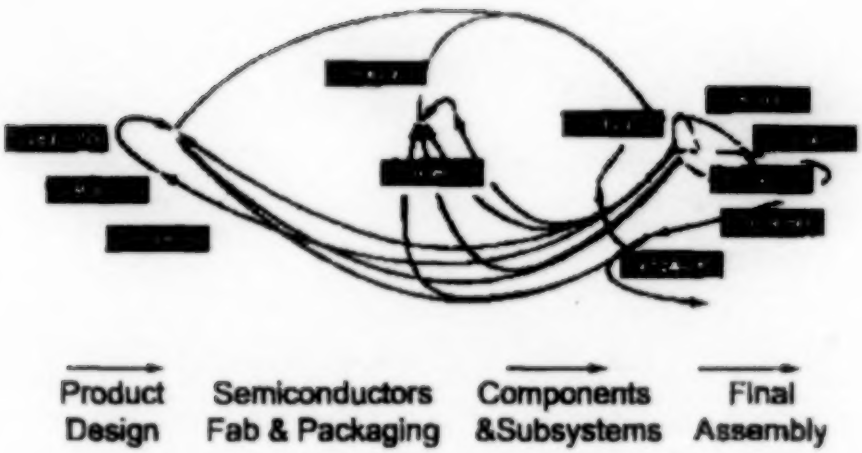
B. The Federal Circuit's contrary rule could permit companies to sell their products as "single use only," and sue anyone who resells or reuses them for patent infringement. Additionally, it could allow companies to use patent infringement suits to prevent purchasers from repairing broken machines.

The Federal Circuit denied that its holding would cause such "wide-spread problems" because "*Mallinckrodt* has been the governing case law since 1992." Pet. App. 60a. But *Mallinckrodt* has not caused greater chaos to date for the same reason it should be rejected: It is so far outside of this Court's existing exhaustion precedent that some patent holders have been hesitant to strongly rely on it. Affirming the Federal Circuit's en banc holding below could unleash a range of post-sale restrictions that fundamentally reshape the patent law landscape and injure consumers and businesses alike. This Court should reverse.

ARGUMENT

I. The Court Should Reject The Federal Circuit's Holding That An Authorized Foreign Sale Does Not Exhaust U.S. Patent Rights.

Here is an image of a typical international supply chain for a high-tech product:



As the image shows, a product may be designed in the United States, assembled in Singapore from parts made in Costa Rica, Israel, and China, and then shipped to the United States for sale.[2] Intel's multi-tier supply chain, for example, comprises more than 16,000 suppliers in over 100 countries. Likewise, more than 750 companies supply components from over 30 countries that are incorporated in iPhones and iPads. *See* Ian Barker, *The Global Supply Chain Behind the iPhone 6*, betanews (Sept. 23, 2014), http://tinyurl.com/jrsxpxq. Dell relies on suppliers across six continents. *See* http://tinyurl.com/jqx8rz5 (map of Dell suppliers). And VIZIO relies on foreign manufacturers to procure components and assemble VIZIO's complex products.

The en banc Federal Circuit's decision, reaffirming the rule announced in *Jazz Photo*, threatens this global market. Under the Federal

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[2] *See* Mark Zetter, *Economic Drivers, Challenges Creating Regional Electronics Industry*, Venture Outsource, http://tinyurl.com/zokrprg (last visited Jan. 20, 2017).

Circuit's ruling, even if a U.S. patent holder authorizes a sale of her patented product abroad and receives her patent reward, she can still sue downstream purchasers for patent infringement. That holding is contrary to this Court's established precedent and, if affirmed, would damage the global high-tech industry.

A. For purposes of U.S. patent exhaustion, what matters is that an authorized sale has taken place, not where it occurs.

In determining the scope of patent exhaustion, what matters is that an authorized sale has taken place, not where. For example, in *Betts v. Willmott*, Lord Hatherley held that "inasmuch as [the seller] has the right of vending the goods in *France* or *Belgium* or *England*, or in any other quarter of the globe, he transfers with the goods necessarily the license to use them wherever the purchaser pleases." [1871] 6 L.R. 239, 245 (Ch. App.) (Eng.). Similarly, in *Holiday v. Mattheson*, 24 F. 185, 186 (C.C.S.D.N.Y. 1885), the court held that the purchaser "acquire[s] the right of unrestricted ownership in the article he buys as against the vendor" even if the article is purchased abroad. Much more recently, this Court held that the "'first sale' doctrine applies to copies of a copyrighted work lawfully made abroad." *Kirtsaeng v. John Wiley & Sons, Inc.*, 133 S. Ct. 1351, 1355-56 (2013).

The Federal Circuit purported to take a different rule from *Boesch v. Graff*, 133 U.S. 697 (1890), *see* Pet. App. 83a-84a. The Federal Circuit relied on *Boesch* to hold "that there is no legal rule that U.S. rights are waived ... simply by virtue of a foreign sale, either

made or authorized by a U.S. patentee." Pet. App. 64a. But the Federal Circuit's understanding of *Boesch* was flawed. In *Boesch*, there was *no* foreign sale "either made or authorized by a U.S. patentee." *Id.* The patentee patented an improvement in lamp burners, both in the United States and in Germany. *Boesch*, 133 U.S. at 698-99. Defendants purchased the patented burners in Germany from an individual who did not have authorization to sell them from the U.S. or German patent holder. *Id.* at 699, 701. But because he had "made preparations to manufacture the burners prior to the application for the German patent," his sale was exempted under German law. *Id.* at 701. The Supreme Court held the patent not exhausted because the seller had no authority for the sale from the U.S. patent holder, and thus, "purchasers from him could not be thereby authorized to sell the articles in the United States in defiance of the rights [of] patentees." *Id.* at 703.

Courts have consistently recognized that the crucial fact in *Boesch* was that there was no sale authorized by the U.S. patent holder—in other words, the patent holder never received his one reward. In *Curtiss Aeroplane & Motor Corp. v. United Aircraft Engineering Corp.*, for instance, the patent owner manufactured and sold airplanes to the British government in Canada. 266 F. 71, 72-74 (2d Cir. 1920). Defendant purchased the airplanes from the British government in Canada and sold them in the United States. *Id.* at 74. Yet the court held the "full right to use and sell the article in any and every country" had passed to the purchaser, because *"[a]s the plaintiff has already been paid for these aeroplanes the full price it asked,* it is no longer concerned about

... whether the article is kept in Canada, or in Great Britain, or in the United States." *Id.* at 78-79 (emphasis added).[3]

Boesch therefore did not displace or create an exception to the common law rule that an authorized first sale of an article—during which the patent holder receives her patent reward—exhausts U.S. patent rights in that article. *See Kabushiki Kaisha Hattori Seiko v. Refac Tech. Dev. Corp.*, 690 F. Supp. 1339, 1342 (S.D.N.Y. 1988) (holding that after a foreign sale by an authorized licensee, "the holder of United States patent rights is barred from preventing resale in the United States or from collecting a royalty when the foreign customer resells the article here").

B. The high-technology industry's experience with *Jazz Photo* demonstrates its many flaws.

1. Because of *Jazz Photo*, companies like *amici*—who make devices that implicate thousands of patents—must secure licenses to protect themselves and their customers from claims of patent infringement, even for products that were purchased abroad in sales authorized by the U.S. patent holder for which the patent holder already collected her reward.

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[3] Contrary to Lexmark's assertion, there was no contractual "global license that covered the United States" (Opp. 22-23) in *Curtiss Aeroplane*—the decision was based on exhaustion. *See* 266 F. at 77.

For example, Intel's 2011 cross-license with NVIDIA specifies that patent exhaustion will occur "in each case, regardless of the jurisdiction in which such Licensed Products were first sold or manufactured, to the same extent that the Patent Rights of the licensor Party in such Licensed Product would be deemed to have been exhausted under United States law if such Licensed Products were first sold in the United States." *See* NVIDIA Corp., Current Report (Form 8-K), at § 3.2(c) (Jan. 10, 2011), http://tinyurl.com/h7ta4hj. Intel negotiated similar terms with RealNetworks in 2012. *See* Patent License Agreement Between RealNetworks, Inc. and Intel Corp., at § 2.1(c) (Jan. 26, 2012), http://tinyurl.com/jucpl6m. And Intel's 2009 cross-license with Advanced Micro Devices includes the right for Intel to sell licensed products, but also "for purposes of clarity, includes the right for Intel's customers, direct and indirect, to use, sell, offer to sell, import and otherwise dispose of all Intel Licensed Products." *See* Patent Cross License Agreement Between Advanced Micro Devices, Inc. and Intel Corp., § 3.1(a) (Nov. 11, 2009), http://tinyurl.com/zp284uu.

Lexmark argues that complicated licenses are how patent exhaustion *should* work. According to Lexmark, *amici* "can protect their supply chains and intellectual property through the contracts, licenses, warranties, indemnification, and insurance that already characterize their cross-border transactions." Opp. 32.

But application of the Federal Circuit's rule would require this kind of licensing to be duplicated at each level of the supply chain. A downstream purchaser

cannot be assured that its upstream supplier has secured exhaustion without reviewing the license between the upstream supplier and the patent holder. But "the terms of patent-licensing agreements ... are generally confidential." John M. Golden, *Principles for Patent Remedies*, 88 Tex. L. Rev. 505, 550 (2010).[4]

Thus, some patent holders attempt to force downstream purchasers to pay again for their own licenses to technology already licensed to their suppliers. *See, e.g.*, Brief of Dell Inc. et al. as *Amici Curiae* in Support of Petitioners, *Quanta*, 553 U.S. 617 (No. 06-937), 2007 WL 3407021, at *17 (patentee sent Dell a "notice letter" regarding technology found in Intel chips used in Dell components suggesting that Dell would need to purchase a license directly from patentee).

Where a downstream purchaser must negotiate directly with an upstream patent holder for a license to a technology that it did not specifically incorporate into its product (its subcomponent or component supplier did), it is at a serious information disadvantage. "Because the downstream purchaser[] did not design

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[4] Some licenses may be disclosed in litigation. But parties routinely—and appropriately—fight to avoid disclosing confidential licensing terms or even the existence of licenses, and licenses that are disclosed in litigation are often designated "Outside Counsel's Eyes Only," so in-house lawyers cannot review them. *See, e.g., In re Elec. Arts, Inc.*, 298 F. App'x. 568 (9th Cir. 2008) (granting writ of mandamus and ordering licensing terms sealed); *MMI, Inc. v. Baja, Inc.*, 743 F. Supp. 2d 1101, 1106 (D. Ariz. 2010) (sealing a licensing agreement because it included information about the "royalty rate [the company] charges its licensees, and the terms and conditions to which [the company] subjects its licensees").

the accused technology, [it does] not possess the technical information to effectively defend against the patents" and must "conduct extensive third party discovery." Samuel F. Ernst, *Patent Exhaustion for the Exhausted Defendant: Should Parties Be Able to Contract Around Exhaustion in Settling Patent Litigation?*, 2014 U. Ill. J.L. Tech. & Pol'y 445, 476 (2014). Even with such discovery, the downstream purchaser may not be able to evaluate the patent or to calculate the value of the technology to its product. Nor can it make a fully informed decision about whether to license the patent because the supplier's information is typically restricted to "outside counsel's eyes only." *See, e.g., Certain Flash Memory Chips & Prods. Containing Same*, Inv. No. 337-TA-735, Order No. 10, 2010 WL 4790336 (USITC Oct. 13, 2010) (denying motion to amend protective order to permit in-house counsel to view confidential business information, noting "general rule that precludes in-house counsel from accessing" such information).

Finally, licensing imposes massive transaction costs. In 2001, the cost of negotiating a patent license was estimated at $50,000 *per licensee per patent*. Mark A. Lemley, *Rational Ignorance at the Patent Office*, 95 Nw. U. L. Rev 1495, 1507 (2001). The total cost for licensing the patents in a single high-tech product could thus be in the tens, if not hundreds, of millions of dollars. Where the patent holder has already received her reward for the sale of a patented component, there is no corresponding benefit to justify this massive cost.

Lexmark insists that negotiating express licenses is no more burdensome than figuring out if the international sale was "authorized." According to Lexmark, even with a rule of international exhaustion, a final product manufacturer would still need to "assure itself that each component was acquired from a seller with authority to transfer any applicable patent rights." Opp. 33. But companies typically publish lists of their authorized sellers. *See, e.g.*, Intel Authorized Distributor List, http://tinyurl.com/jn2s742. For instance, Intel has pioneered a traceable supply chain that "enable[s] end-users to validate where and when every component of a server was manufactured." *See* Intel Transparent Supply Chain, http://tinyurl.com/jb5e46c; *see also* Dell Supply Chain, http://tinyurl.com/jqx8rz5. Thus, finding out whether a distributor was authorized to sell the product is vastly different from negotiating an express license with every single upstream patent holder.

2. Even companies with the sophistication and resources to enter into express licensing agreements have not avoided lawsuits filed by patent assertion entities ("PAEs"). PAEs are increasingly buying up previously licensed patents and seeking second and third patent rewards from downstream purchasers. *See* Mark S. Popofsky & Michael D. Laufert, *Patent Assertion Entities and Antitrust: Operating Company Patent Transfers*, The Antitrust Source, at 1, 3 (Am. Bar Ass'n, 2013); *SanDisk Corp. v. Round Rock Research LLC*, No. 11-CV-5243, 2014 WL 2700583 (N.D. Cal. June 13, 2014) (targeting SanDisk, a downstream purchaser of semiconductor memory devices that were subject to a worldwide license); *Multimedia Patent Tr. v. Apple Inc.*, No. 10-CV-2618, 2012 WL

6863471, at *5 (S.D. Cal. Nov. 9, 2012) (relying on *Jazz Photo* to assert patent infringement against customer of a supplier with a worldwide patent license); *LaserDynamics, Inc. v. Quanta Storage Am., Inc.*, No. 06-CV-348, 2009 WL 3763444, at *1 (E.D. Tex. June 29, 2009), *rev'd on other grounds sub nom. LaserDynamics, Inc. v. Quanta Comput., Inc.*, 694 F.3d 51 (Fed. Cir. 2012) (arguing foreign sales by licensee did not exhaust U.S. patent rights for downstream customer).

PAEs have also already targeted downstream purchasers of high-tech goods originally sold in authorized sales abroad. *Minebea Co. v. Papst*, 374 F. Supp. 2d 202, 216 (D.D.C. 2005) (patentee argued that under *Jazz Photo*, authorized sale abroad did not exhaust patent holder's U.S. patent rights); *Robert Bosch LLC v. Alberee Prods., Inc.*, 171 F. Supp. 3d 283, 288-89 (D. Del. 2016) (same); *STMicroelectronics, Inc. v. SanDisk Corp.*, No. 05-CV-45, 2007 WL 951655, *2-3 (E.D. Tex. Mar. 26, 2007) (same).

By targeting companies like Dell and VIZIO that sell finished products, PAEs try to secure larger payments based on the entire price of the product, rather than the value of the patented technology. *See, e.g., LaserDynamics, Inc.*, 694 F.3d at 60, 65 (patentee's damages expert testified that damages would be $52.1 million if based on entire laptop computer and $10.5 million if based on subcomponent). The Federal Circuit's entire market value rule attempts to address this problem, but many PAEs have circumvented this rule by avoiding explicitly pegging their damages demand to the price of the finished product but conflating the value of the

patented technology in a component with the value from non-patented features in the finished product. *See, e.g., VirnetX, Inc. v. Cisco Sys., Inc.*, 767 F.3d 1308, 1325-29 (Fed. Cir. 2014) (describing expert damages models that did not apportion value of the patented technology: "patentee's obligation to apportion damages only to the patented features does not end with the identification of the smallest salable unit if that unit still contains significant unpatented features"). Even with the entire market value rule, defending against finished product suits is extremely costly. In 2015, the median cost of defending a patent infringement suit brought by a PAE with $1-10 million at risk was $1 million, and the median cost of defending a suit with over $25 million at risk was $3.8 million. Am. Intellectual Prop. Law Ass'n, *Report of the Economic Survey*, at 38 (2015).

3. The Federal Circuit denied that "substantial problems have arisen with the clear rule of *Jazz Photo*, which has been in place since 2001" and asserted that "[o]verturning *Jazz Photo*" is what "would plausibly cause significant disruption of existing practices." Pet. App. 98a, 100a; *see also* Opp. 31 ("The sirens sounded by *amici* ... fail to resonate where the court merely affirmed existing precedent."). But the Federal Circuit failed to acknowledge the problems discussed above (at 10-16).

Moreover, *Jazz Photo* has not been "the clear rule" for many years. Many considered it wrong when decided. *See, e.g.*, John A. Rothchild, *Exhausting Extraterritoriality*, 51 Santa Clara L. Rev. 1187, 1196-1216 (2011) (disputing the Federal Circuit's reasoning in *Jazz Photo* and collecting contrary precedent). Then,

following *Quanta*, 553 U.S. 617, which involved some foreign sales, at least one court held that *Quanta* had abrogated *Jazz Photo*. *See LG Elecs., Inc. v. Hitachi, Ltd.*, 655 F. Supp. 2d 1036, 1047 (N.D. Cal. 2009) ("The Court therefore concludes that *Quanta's* holding—that exhaustion is triggered by the authorized sale of an article that substantially embodies a patent—applies to authorized foreign sales as well as authorized sales in the United States."); Pet. Br. 48-49. The Federal Circuit rejected that view in *Ninestar Tech. Co. v. Int'l Trade Comm'n*, 667 F.3d 1373, 1378 (Fed. Cir. 2012), but *Jazz Photo* was quickly called into question again by *Kirtsaeng*. *See SanDisk Corp.*, 2014 WL 2700583, at *4 (noting that "*Kirtsaeng* implicitly suggests" that *Jazz Photo* was wrong).

Contrary to the Federal Circuit's assertion, Pet. App. 74a-75a, 99a, the practical considerations animating *Kirtsaeng* apply with equal or greater force in the patent context. Just as this Court warned in *Kirtsaeng*, the rule of *Jazz Photo* invites accidental infringement by consumers and companies. *See* 133 S. Ct. at 1364-67 (giving examples of possible inadvertent copyright infringement). As in *Kirtsaeng*, a consumer who purchases a phone,[5] a new pair of golf

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[5] A generic smartphone assembled from various high-tech components could practice an estimated 250,000 patents. *See* RPX Corp., Registration Statement (Form S-1), at 59 (Sept. 2, 2011), http://tinyurl.com/gnlzbr9.

shoes,[6] or even a package of diapers[7] while on a trip abroad could find herself liable for patent infringement upon her return to the United States. And U.S. residents spent an estimated $119 billion overseas in 2008. Michael Armah and Teresita Teensma, *Estimates of Categories of Personal Consumption Expenditures Adjusted for Net Foreign Travel Spending*, Bureau Of Economic Analysis, U.S. Department of Commerce 15 (Apr. 2012), http://tinyurl.com/z2umlrr.

At least in *Kirtsaeng*, the possible suits against consumers were hypothetical. *See* 133 S. Ct. at 1366-67. Not so in the patent context, where there already exists "a class of patentees that overwhelmingly acquire old, extremely weak patents and assert them against the numerous, unsophisticated purchasers (rather than manufacturers) of allegedly infringing products in suits that typically settle for less than defendants' anticipated litigation costs." Brian J. Love & James C. Yoon, *Expanding Patent Law's Customer Suit Exception*, 93 B.U. L. Rev. 1605, 1609-10 (2013); *see, e.g.*, *Vt. v. MPHJ Tech. Invs., LLC*, 803 F.3d 635, 639 (Fed. Cir. 2015), *cert denied* 136 S. Ct. 1658

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[6] The Patent Office has issued 348 patents in classification 36/127 ("Athletic shoe or attachment therefor", "for golf"), USPTO Patent Full-Text and Image Database, http://tinyurl.com/jpdurnu (last visited Jan. 20, 2017)

[7] The Patent Office has issued 1,114 patents in classification 604/358 ("Absorbent pad for external or internal application and supports therefor (*e.g.*, catamenial devices, diapers, etc.)"), USPTO Patent Full-Text and Image Database, http://tinyurl.com/orwy26y (last visited Jan. 20, 2017).

(2016); *In re Innovatio IP Ventures, LLC Patent Litig.*, No. 11 C 9308, 2013 WL 5593609, at *1 (N.D. Ill. Oct. 3, 2013).

This Court should hold that foreign sales authorized by U.S. patent holders exhaust U.S. patent rights. Otherwise, transaction costs at each level of the supply chain will increase, and will be passed on to consumers, without a corresponding public benefit. Ernst, *supra*, at 472.[8]

C. The Solicitor General's presumptive international exhaustion rule would not solve the problems with *Jazz Photo*.

The Solicitor General recognized that the Federal Circuit erred "in reaffirming its holding in [*Jazz Photo*] that foreign sales *never* exhaust U.S. patent rights." U.S. Cert. Br. 6. However, the government asserted that the Court should hold that an authorized foreign sale *presumptively* exhausts U.S. patent rights, but a patentee may nonetheless reserve her "U.S. patent rights ... expressly." *Id.*

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[8] Lexmark asserts that "[e]ffectively requiring patentees to price the value of U.S. patent rights into every foreign sale" would be especially problematic "where lifesaving drugs ... are at stake." Opp. 30, 32. But concerns about market segmentation of pharmaceuticals are "a red herring because [of the] unique features of pharmaceuticals." Ariel Katz, *The First Sale Doctrine and the Economics of Post-Sale Restraints*, 2014 BYU L. Rev. 55, 79 (2014). Pharmaceutical imports and exports are heavily regulated, so a rule of international exhaustion is, contrary to the en banc majority's assertion (at Pet. App. 101a), unlikely to undermine a pharmaceutical company's ability to price discriminate across countries. *See also* SanDisk Cert. Br. 15 n.7.

This rule lacks a principled legal basis and would possibly cause more confusion than the Federal Circuit's approach. The government's proposed approach would tell businesses and consumers that patent rights are sometimes exhausted in foreign sales, and sometimes not, leaving the businesses and consumers to figure out whether sufficient express reservations had been made. Further, a presumptive exhaustion rule could encourage patent holders to reserve their rights as discreetly as possible and then lie in wait and sue for infringement once a finished product hits the United States. It could also create a cottage industry of litigation around when a reservation is sufficiently express.

The government attempts to justify its approach by pointing to two bilateral free trade agreements with Australia and Morocco from 2004. U.S. Cert. Br. 18-20. Those two agreements specify that the parties shall preserve "the exclusive right of the patent owner to prevent importation of a patented product, or a product that results from a patented process" notwithstanding a foreign sale of that product, "at least where the patentee has placed restrictions on importation by contract or other means." United States-Australia Free Trade Agreement, Aus.-U.S., May 18, 2004, Art. 17.9.4, KAV 6422; United States-Morocco Free Trade Agreement, Morocco-U.S., June 15, 2004, Art. 15.9.4 & n.10, 44 I.L.M. 544 (using similar language).

However, those two bilateral agreements do not set U.S. law or policy, and nothing in either agreement requires the signatories to provide patent holders with a remedy in *patent law* as opposed to *contract*

law. A rule of international exhaustion would still allow patent holders to prohibit the importation of products using contract law. For example, a patent holder could enter into a contract with a purchaser overseas that prevented the purchaser from importing the patented product into the United States. If the purchaser went ahead and imported the product into the United States anyway, the patent holder could sue for breach of contract. *See, e.g., Quanta*, 553 U.S. at 637 n.7 (distinguishing patent rights from contract rights that may be separately asserted); *Bloomer v. McQuewan*, 55 U.S. 539, 549-50 (1852) (observing that once a product "passes to the hands of the purchaser, it is no longer ... under the protection of" federal patent laws but remains subject to state laws that govern "[c]ontracts in relation to it").

Relying on contract law would limit legal liability to the parties to the contract, and those in privity with them, without imposing a servitude on the product itself. In other words, patent holders would be required to sue those with whom they contract, rather than downstream purchasers. And the remedies available for breach of contract are generally limited to compensatory damages, *see* U.C.C. § 1-106 (describing compensatory damages for contract actions), whereas remedies for patent infringement include injunctive relief and treble damages, *see* 35 U.S.C. §§ 283, 284.[9]

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[9] A contemporaneous 2003 bilateral free trade agreement between the United States and Singapore cited by the en banc majority, *see* Pet. App. 88a, illustrates this point. *See* United

II. The Court Should Reject The Federal Circuit's Holding That Post-Sale Restrictions Are Enforceable Through Patent Law After An Authorized Sale.

The Federal Circuit's decision disregarded a second necessary consequence of the Court's 165-year-old rule that after an inventor chooses to "lawfully sell" a patented machine, the "machine passes to the hands of the purchaser" and "passes outside" of patent law. *Bloomer*, 55 U.S. at 549. Namely, "the initial authorized sale of a patented item terminates all patent rights to that item," *Quanta*, 553 U.S. at 625, and "confers on the purchaser, or any subsequent owner, 'the right to use [or] sell' the thing as he sees fit," *Bowman v. Monsanto Co.*, 133 S. Ct. 1761, 1766 (2013) (quoting *Univis Lens Co.*, 316 U.S. at 249-50). In its brief, the United States therefore urged this Court to correct "the Federal Circuit's erroneous limitation on

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States-Singapore Free Trade Agreement, Sing.-U.S., May 6, 2003, Art. 16.7.2, 42 I.L.M. 1026 (2003). Article 16.7.2 of the agreement provides that "[e]ach Party shall provide a cause of action to prevent or redress the procurement of a patented pharmaceutical product, without the authorization of the patent owner, by a party who knows or has reason to know that such product is or *has been distributed in breach of a contract* between the right holder and a licensee, regardless of whether such breach occurs in or outside its territory." *Id.* (emphasis added). The agreement further states that "[a] Party may limit such cause of action to cases where the product has been sold or distributed only outside the Party's territory before its procurement inside the Party's territory." *Id.* at n.16-10. That language is consistent with a rule of automatic international exhaustion—an authorized first sale abroad removes a product from the reach of patent law—but still allows for other remedies to redress unauthorized importation, such as breach of contract and tort.

the scope of patent exhaustion following an authorized first sale in the United States." U.S. Cert. Br. 15.

A. Exhaustion applies to patentees who license others to manufacture products just as it applies to patentees who manufacture their own products.

The en banc majority's stated reason for going against more than a century of Supreme Court precedent was to avoid creating a "distinction that gives less control to a practicing-entity patentee that makes and sells its own product than to a non-practicing-entity patentee that licenses others to make and sell the product." Pet. App. 26a; *see also* Pet. App. 30a, 32a, 34a, 37a, 41a, 45a, 49a (discussing purported patentee-sale/licensee-sale distinction). Lexmark has similarly argued that the "court of appeals properly refused to insert this novel and arbitrary distinction ... into the controlling text." Opp. 1.

As the government correctly acknowledged, however, there is no such distinction. U.S. Cert. Br. 11-14. The rule is the same for non-practicing entities and practicing entities alike: Once there has been a first sale authorized by the U.S. patent holder, the patent holder may not restrain the use or resale of the patented article through the patent law. *See, e.g.*, *Boston Store v. Am. Graphophone Co.*, 246 U.S. 8, 25 (1918) ("[O]ne who had sold a patented machine and received the price and had thus placed the machine so sold beyond the confines of the patent law, could not by qualifying restrictions as to use keep under the patent monopoly a subject to which the monopoly no longer applied.").

The foundation of the Federal Circuit's error was its mistaken belief that had "Lexmark ... granted another firm a nonexclusive license to make and sell Return Program cartridges," rather than selling them with the post-sale restrictions itself, "[i]t is undisputed and clear under ... the 1938 decision in *General Talking Pictures* ... that Lexmark would not have exhausted its patent rights in those cartridges, upon the manufacturing licensee's sale (the first sale), if a buyer with knowledge of the restrictions resold or reused them in violation of the restrictions." Pet. App. 26a; *see also* Opp. at 19 ("[P]atentees can achieve the same results through licenses.").

That is wrong. An authorized sale by a licensee, made within the scope of a valid patent license, exhausts the patent holder's patent rights, and the patent holder may not then use the patent law to enforce a post-sale restriction against a purchaser. Thus, had Lexmark granted another company a license to make and sell its patented ink cartridges but required the company to affix a sticker that said "single use only," and the other company had complied, Lexmark could not bring a patent infringement suit against a purchaser who refilled and re-used the cartridges despite the sticker. Although Lexmark or its licensee may have a breach of contract action against the purchaser who violated the terms of the sticker, Lexmark's *patent rights* would have been exhausted because the sale by the licensee to the purchaser was authorized by Lexmark. *See, e.g.*, *United States v. Gen. Elec. Co.*, 272 U.S. 476, 489-90 (1926); Mark R. Patterson, *Contractual Expansion of the Scope of Patent Infringement Through Field-of-Use Licensing*, 49 Wm. & Mary L. Rev. 157, 164-65 (2007) ("manufacturing licensees

in effect stand in the shoes of the patentee, and imposing use restrictions on them can reasonably be treated as economically equivalent to individual decisions by the patentee itself").

Despite the Federal Circuit's confusion, *General Talking Pictures* is not to the contrary. There, the patent holder granted a nonexclusive license to American Transformer Company to manufacture and sell its patented amplifiers only for individual home use, not for commercial use. *Gen. Talking Pictures v. W. Elec. Co.*, 304 U.S. 175, 179-80 (1938). Despite the limited license, American Transformer Company knowingly violated the licensing agreement and sold amplifiers to a movie company (i.e., for commercial use). *Id.* at 180. The Court held that the sales "were outside the scope of [the] license and not under the patent" and thus constituted patent infringement. *Id.* at 180-82. On rehearing, the Court again held that when the terms of a restricted license are violated by the licensee, a sale "outside the scope of the license ... is precisely the same as if no license whatsoever had been granted." 305 U.S. 124, 127 (1939).

The Court specifically noted that it had "no occasion to consider" what the outcome would have been had there been an authorized sale under the license accompanied by a "notice which purports to restrict the use of [the] articles lawfully sold." *Id.* at 127 (internal quotation mark omitted). It did not hold that where there has been an authorized sale by a licensee, patent rights are still not exhausted, and the patent owner may still use the patent law to enforce post-sale restrictions against downstream users. Rather, it

held that without an authorized sale, there is no exhaustion.

General Talking Pictures is thus a case where the patent owner's patent rights were not exhausted *because there was no authorized sale.* The rule is the same regardless of who makes the sale: The first authorized sale of a patented article exhausts the patent holder's patent rights.

This Court confirmed that understanding again in *Quanta*, emphasizing that "the initial authorized sale of a patented item terminates all patent rights to that item." *Quanta*, 553 U.S. at 625. As the Court elaborated, "[t]he authorized sale of an article that substantially embodies a patent exhausts the patent holder's rights and prevents the patent holder from invoking patent law to control postsale use of the article." *Id.* at 638. Further, the Court specifically noted that it had long ago rejected the ability of patentees to impose "postsale restrictions on the use of a patented article." *Id.* at 625-26.

At bottom, as *Quanta* recognized, "the primary purpose of our patent laws is not the creation of private fortunes for the owners of patents but is 'to promote the progress of science and useful arts.'" *Id.* at 626 (quoting *Motion Picture Patents Co. v. Universal Film Mfg. Co.*, 243 U.S. 502, 511 (1917) (quoting U.S. Const., art. I, § 8, cl. 8)). Patent exhaustion embodies that purpose by limiting a patentee to *one* royalty.

B. The Federal Circuit's endorsement of *Mallinckrodt* could allow patent holders to end secondary markets in patented goods.

1. It might be bad for business, but under the Federal Circuit's rule, any patentee could sell her product as "single use only," and then attempt to sue a purchaser for patent infringement if she resells or reuses it. As a high-tech example, videogame companies could sell their games as "single use only," and sue anyone who resold them, in an attempt to shut down the market for secondhand videogames. And there should be no doubt that PAEs are willing to go after individual customers for patent infringement. *Supra* at 14-16 (discussing customer suits).

Appliance manufacturers could similarly try to prevent purchasers from repairing or modifying their washing machines or dishwashers simply by labeling them "as-is," or "without modification." *See* Richard H. Stern, *Post-Sale Patent Restrictions After Mallinckrodt—An Idea in Search of Definition*, 5 Alb. L.J. Sci. & Tech 1, 14-15 (1994) (explaining how *Mallinckrodt* provides "a detour" around repair and modification doctrines); *see, e.g., Aro Mfg. Co. v. Convertible Top Replacement Co.*, 365 U.S. 336, 346 (1961) (holding "[m]ere replacement of individual unpatented parts ... is no more than the lawful right of the owner to repair his property" and is not infringing). The appliance repair and maintenance industry was worth $2.4 billion in 2010. *See* U.S. Census Bureau, Service Annual Survey 2010, at 203, 441 (Feb. 2012), http://tinyurl.com/hoxem33.

Lexmark asserts any such restrictions would be accompanied by "reduced prices [that] reflect the value of what is conveyed," and there is thus no potential for a "double recover[y]." Opp. 19. But that is a matter of grace—it is not required by the Federal Circuit's holding. The holding permits patent holders to charge whatever they want for products labeled single use, and then sue anyone who attempts to reuse or resell them for patent infringement. That is contrary to the long-established and oft-repeated rule that "the payment of a royalty once, or, what is the same thing, the purchase of the article from one authorized by the patentee to sell it, emancipates such article from any further subjection to the patent." *Keeler v. Standard Folding-Bed Co.*, 157 U.S. 659, 666 (1895).

2. The Federal Circuit denied that its holding would cause such "wide-spread problems" because "*Mallinckrodt* has been the governing case law since 1992." Pet. App. 60a. Similarly, Lexmark has asserted that "*amici's* sweeping claims about the imminent demise of U.S. commerce ... ring hollow" because they "have not come to pass in the years since" *Mallinckrodt* was decided. Opp. 2.

But just as the Federal Circuit missed the uncertainty and unfairness *Jazz Photo* has left in the high-technology community, it misunderstood why *Mallinckrodt* has not caused greater chaos to date. Almost immediately after the Federal Circuit decided *Mallinckrodt*, one commentator noted that taking the holding of the case "at face value may require a certain amount of willing suspension of disbelief," and

companies that used it to engage in "aggressive business strategies" might "later be embarrassed by a judicial retreat from it and a return to the exhaustion doctrine." Stern, *supra*, at 8-9; *see also* Richard H. Stern, *The Unobserved Demise of the Exhaustion Doctrine in U.S. Patent Law*, 12 Eur. Intell. Prop. Rev. 460, 465 (1993) (describing *Mallinckrodt* as inconsistent with over a century of Supreme Court precedent, unprincipled, doctrinally unsound, and "insupportable, except as an exercise in judicial legislation").

In the ensuing years, *Mallinckrodt* remained "a controversial decision that left so many questions unanswered that businesses were hesitant to implement the kind of aggressive use restrictions that the Federal Circuit arguably sanctioned." Steven A. Maddox & David W. Slaby, *Despite a Recent Case Holding that Refilling Patented Toner Cartridges Does Not Constitute Infringement, Manufacturer Claims Its 'Single-Use' Patent is Tenable*, Nat'l L. J., Feb. 9, 1998, at B4. Then, many leading commentators thought this Court "unanimously rejected" *Mallinckrodt* in *Quanta*, and "restored the first sale rule to its original broad scope." Herbert Hovenkamp, *Post-Sale Restraints and Competitive Harm: The First Sale Doctrine In Perspective*, 66 N.Y.U. Ann. Survey of Am. L. 487, 502 (2011); *see also* Pet. Br. 23-24 n.5. Affirming the Federal Circuit's holding below, however, could make *Mallinckrodt* a mainstream tactic for seeking unwarranted gains.

CONCLUSION

Amici urge this Court to hold once again that a sale authorized by a U.S. patent holder conclusively exhausts U.S. patent rights.

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